The Federal Report

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM

The Month in Washington: October 2005

October was not kind to the Bush administration. Vice president Cheney's chief of staff, I. Lewis "Scooter" Libby was indicted by the grand jury investigating the CIA leak case and resigned, while Karl Rove, probably the most important presidential advisor, was spared indictment but remains under investigation as Democrats call for him to be removed from his post. Harriet Miers, the president's nominee to replace Sandra Day O'Connor on the U.S. Supreme Court, withdrew her nomination following a near-revolt among Republicans at what was perceived to be a weak selection. More revelations surfaced about the federal government's much-criticized initial response to Hurricane Katrina, with the only Federal Emergency Management Agency (FEMA) official who was in New Orleans at the time of the hurricane recounting his repeated and unsuccessful efforts to convince FEMA Director Michael Brown of the desperate nature of the situation. And, even as some positives emerged from Iraq, with Iraqis going to the polls in large numbers to approve a constitution and Sunnis appearing to take more of an interest in the political process, the violence continued, with U.S. deaths surpassing 2,000. Some observers see a White House in disarray and wonder if this administration, which operated so smoothly for so long, can get back on track.

Issues and Events

CalPERS Opposes Patent Extensions

A proposal being considered by Congress that would extend certain prescription drug patents would "dramatically increase health care costs for all Americans," CalPERS Deputy Executive Officer for Benefits Administration Jarvio Grevious wrote in a letter to two senior senators.

The Senate Health, Education, Labor and Pensions (HELP) Committee on Oct. 24 reported the Biodefense and Pandemic Vaccine and Drug Development Act of 2005, a bill from Sen. Richard Burr, R-N.C., that would, among other things, extend from seven to 10 years the patents on drugs that could be used during biological, chemical, radiological or nuclear attacks. While the idea behind the measure is to encourage the development of such drugs, CalPERS and other critics say the primary effect would be to keep drug prices high by delaying the appearance on the market of generic equivalents, which are significantly cheaper than brand-name drugs.

"[I]ncluding market exclusivities for existing everyday medicines would substantially increase costs and set a precedent that private and public health insurers cannot afford," Grevious wrote in the Oct. 27 letter to HELP Committee Chairman Mike Enzi, R-Wyo., and Ranking Democrat Ted Kennedy of Massachusetts. "At a time when all health care purchasers are struggling to keep costs down, we urge you not to exacerbate the problem unnecessarily."

Other groups, such as AARP, have lodged similar objections to the bill, which awaits action by the full Senate.

GPO Reform Bill Proposed

Retirees who collect pensions from jobs that were not covered by Social Security would take a much smaller hit from Social Security's government pension offset (GPO) if legislation proposed recently by a Maryland senator becomes law.

GPO reduces Social Security spousal and survivor's benefits for retirees who collect pensions from jobs that were not covered by Social Security by an amount equal to two-thirds of the pension. The Government Pension Offset Reform Act would make GPO equal to the amount by which two-thirds of a retiree's total monthly income (pension plus Social Security benefit, before application of the offset) exceeds $1,200. (That figure would be adjusted for inflation.)

So, for example, under the current law, a retiree who collects a $1,200 monthly pension from a non-covered job and would, in the absence of GPO, be eligible for a $600 monthly spousal benefit would see no spousal benefit at all, since the $600 would be completely offset by two-thirds of the pension ($800). Under Mikulski's proposal, though, that same retiree would be able to collect the full spousal benefit, since two-thirds of $1,800 – the retiree's total monthly income – equals exactly $1,200.

Mikulski has proposed this measure in previous sessions of Congress, but her bills never made it out of committee. This version is likely to suffer the same fate.

Senator Urges NCHC to Pressure Congress

The National Coalition on Health Care (NCHC) can play a role in pressuring lawmakers to reform the U.S. health care system, a senator told members of the group on Oct. 6.

"There needs to be an outside effort to push us into a decision process," Sen. Dick Durbin, D-Ill., said.

While acknowledging that, "It's a hell of a condemnation of what I do for a living," Durbin indicated that, in the absence of significant pressure for reform, Congress is not likely to take substantial action on the issue.

Later in the meeting, NCHC members discussed the approach they should take to generate momentum for reform, and Michael Johnson of Blue Shield of California suggested the coalition abandon its reluctance to support specific legislative proposals and lend its support to certain bills.

"If we can't get unanimous support, maybe we can get individual members" to support specific bills, Johnson said. This would be a radical change for a group that has always prided itself on operating by consensus.

The consensus rule makes things challenging for a coalition as broad as NCHC, which includes business, labor, civic, church, consumer and public pension groups, including CalPERS. (CalPERS Board member George Diehr sits on the NCHC board.)

"We're at the end of what we can do coming to these meetings and talking," Brenda Girton-Mitchell of the National Council of Churches of Christ in the U.S.A. said. "I say we put something out there and go for it."

NCHC President Henry Simmons and other coalition leaders urged coalition members to contact their congressmen, senators and governors to ask them to support health care reform and indicated that the time is right for the group to make a push on the issue.

"We now need action," Simmons said. "This is a real opportunity for us. We'll be talking to each of you about that."

GAO Releases Study of Retirement Systems

Retirement system reforms in other countries show that the United States would be better off reforming Social Security sooner rather than later, the Government Accountability Office (GAO) reported in a study released Oct. 21.

"Restoring long-term financial balance invariably involves reducing projected benefits, raising projected revenues, or both," the report notes. "Additionally, with early reform, policymakers are more likely to avoid the need for more costly and difficult changes later. Countries that undertook important national pension reform well before undergoing major demographic changes have achieved or are close to achieving, financially sustainable national pension systems."

The GAO, Congress' investigative agency, also found that it was important to educate the public about the issue, especially "in the case of individual account reforms, which require high levels of financial literacy and personal responsibility." It noted, though, that, "Although countries have attempted to educate individuals about reforms and how their choices may affect them, studies in some countries indicate that many workers have limited knowledge about their retirement prospects."

Social Security trustees project that annual program revenues will fall below expenditures in 2017, and the Social Security trust fund will be exhausted in 2041. Republicans had hoped to have Congress vote this fall on a proposal to reform Social Security in a way that added personal investment accounts to the program, but that plan has been shelved as lawmakers work on a lengthy to-do list that includes responding to Hurricane Katrina, holding hearings on Supreme Court nominees and passing already overdue budget bills.

Strategic Recommendations

LGV&A is not offering any new strategic recommendations to the Board this month.

California Congressional Delegation

Congressional Chairmen Seek Support for Pension Bill

A pension reform bill proposed in the House would provide needed clarity to the rules for cash balance plans and should be supported, two committee chairman wrote in an Oct. 26 letter to their colleagues.

Cash balance plans are hybrids of defined benefit and defined contribution plans that include a form of personal accounts but also a guaranteed rate of return. Some conversions from defined benefit plans to cash balance plans in the private sector have led to charges of age discrimination, leaving the legal status of such plans uncertain. The letter from House Ways and Means Committee Chairman Bill Thomas, R-Calif., and House Education and the Workforce Committee Chairman John Boehner, R-Ohio, though, asserts that cash balance plans are “an important component of worker retirement security” that are not inherently discriminatory.

“Cash balance opponents have argued that benefits for younger workers are ultimately higher than benefits provided to older workers because younger workers accrue interest and earn benefits over a longer period of time,” the letter states. “This is tantamount to arguing that the concept of compounding interest is age discriminatory, which would make the most basic savings account illegal.”

A bill proposed by Boehner, the Pension Protection Act of 2005, would clarify the legal status of cash balance plans by establishing an age discrimination standard for all defined benefit plans. In addition, it would revise funding rules for private sector defined benefit plans and increase premiums companies pay to the Pension Benefit Guaranty Corporation (PBGC), the federal agency that insures private sector pensions.

House GOP leaders had planned to combine the bill with Social Security reform legislation, but, now that Social Security reform has basically been shelved, the pension bill is on its own. A related bill in the Senate, the Pension Security and Transparency Act of 2005, has stalled over a provision that would link a company’s credit rating to its pension funding status. The Senate bill includes measures that would affect public pension plans, including ones related to minimum distribution rules, purchase of service credit rules and a waiver of certain early withdrawal penalties for public safety employees.

While both bills are being touted as ways to strengthen the defined benefit system, the PBGC has indicated that its finances would be worse off under either of the proposed reform packages. The agency, which has recently had to take over several large pension plans following the bankruptcies of the sponsoring corporations, is facing a $23 billion shortfall and, in projections provided to lawmakers, it estimated that the House legislation would increase the deficit by $700 million over 10 years, while the Senate bill would result in a $1.5 billion increase in the shortfall.

"This analysis shows that neither the House nor the Senate has come up with legislation to stop the erosion of Americans' retirement security and prevent a taxpayer bailout of the private pension system," Rep. George Miller of California, the ranking Democrat on the Education and the Workforce Committee and one of the leading critics of the House bill, said.

Boehner, however, said the analysis "presents a misleading and inaccurate picture of the Pension Protection Act because it fails to take into account a number of key provisions that strengthen overall pension plan funding."

Related National and Industry News

NASRA Responds to *Time* Pension Story

An article in *Time* about public pension plans "relies on a selective use of statistics and questionable models to mischaracterize the condition of pensions for state and local government employees," the National Association of State Retirement Administrators (NASRA) said in a response to the story.

The story, titled "Where Pensions Are Golden," asserts that state and local governments are having problems funding generous pension and health benefits given to public employees.

"Some public-employee pension plans are well managed and adequately funded. Most are not," the article states, referencing a Wilshire Associates study that found that 54 of 64 state pension systems were underfunded.

Time singled out CalPERS in one paragraph:

> The California Public Employees' Retirement System, better known as CalPERS, handed out a pension check last year for $272,200 to a retired university professor. A former water-district general manager collected $206,300. CalPERS, by the way, invests in vulture funds formed by Wilbur Ross, the New York billionaire who specializes in buying bankrupt companies, slashing costs and then selling the firms for an oversize profit. Among the costs pared: pensions. In short, a public-employee pension fund makes money from the killing of private pensions.

The NASRA response noted that "public pension funds are in reasonably good condition, holding assets equal to nearly 90 percent of their liabilities."

“The story’s examples of lucrative pensions are the exception, not the rule,” according to NASRA. “Moreover, taxpayer contributions to public pension funds are considerably lower now than they have [been] during most of the past decade, both as a percentage of public employees’ pay and of all state and local government spending. The real story is that public pension plans are working, not just for public employees, but also for employers and taxpayers.”